No. 90-333

In The

Supreme Court Of The United States

October Term, 1990

LAMPF, PLEVA, LIPKIND, PRUPIS & PETIGROW,
Petitioner,

v.

JOHN GILBERTSON, et al.,
Respondents.

On Writ of Certiorari to the United States
Court of Appeals for the Ninth Circuit

BRIEF OF BOND INVESTORS ASSOCIATION AS AMICUS CURIAE IN SUPPORT OF RESPONDENTS

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BRIEF OF BOND INVESTORS ASSOCIATION AS AMICUS CURIAE IN SUPPORT OF RESPONDENTS

PRELIMINARY STATEMENT

Pursuant to Rule 37 of this Court, the Bond Investors Association, Inc. ("BIA") submits this brief as amicus curiae in support of the Respondents.[1]

The issue in this case is what statute of limitations should govern actions under Section 10(b) of the Securities Exchange Act of 1934, 15 U.S.C. § 78j(b) and Rule 10b-5 thereunder, 17 C.F.R. 240.10b-5. This Court is asked to decide whether courts should continue the practice previously recognized by this Court in *Ernst & Ernst v. Hochfelder*, 425 U.S. 185, 210 n. 29 (1976) and *Herman & MacLean v. Huddleston*, 459 U.S. 375, 384 n.18 (1983) of borrow-

[1]Written consents signed by all parties have been filed with the Clerk's office.

ing limitations periods from analogous state statutes, or whether 10b-5 claims should be governed by a limitations period borrowed from some federal statute. If the Court adopts a limitations period from some federal cause of action, additional issues will be presented, such as (1) which federal statute should be borrowed, (2) whether federal equitable tolling and equitable estoppel doctrines are applicable to the chosen limitation period, and (3) whether the new limitations period will be applied retroactively.

The BIA urges the Court to continue the practice of adopting state limitations periods, but to do so on a statute-by-statute basis. If the Court decides to adopt a federal limitations period, the BIA urges the Court to adopt either the five-year limitations period drawn from Section 20A of the Securities Exchange Act of 1934, 15 U.S.C. § 78t-1, coupled with equitable tolling, or the three-year from discovery rule applicable to the 10b-5 clone contained in the Interstate Land Sales Full Disclosure Act, 15 U.S.C. § 1701, et seq.

INTEREST OF AMICUS CURIAE

The BIA is a 14,000 member non-profit corporation that provides information to holders of municipal and corporate bonds. BIA was founded in 1984 to assist in providing information to bondholders victimized by the $2.25 billion Washington Public Power Supply Systems ("WPPSS") municipal bond default, and has since expanded its informational services to holders of corporate and other municipal bonds. BIA, which maintains the only comprehensive database on municipal and corporate bond defaults, provides default information and analysis to electronic data services and the public via a monthly newsletter. The information maintained by BIA on defaulted bonds is a unique resource and is regularly used by the SEC, Congress, the General Accounting Office, the Federal Reserve Bank and the media. Much of the statistical information cited by the SEC in its reports on the WPPSS default was obtained from BIA.[2]

[2]See Report of the Securities and Exchange Commission on the Regulation of Municipal Securities, [1988-89 Transfer Binder] Fed.Sec.L.Rep. (CCH) ¶ 84,325 (Sept. 22, 1988); Securities Exchange Act Release No. 26100, [1988-89 Transfer Binder] Fed.Sec.L.Rep. (CCH) ¶ 84,326 (Sept. 22, 1988); Staff Report of the Investigation in the Matter of Transactions in Washington Public Power Supply System Securities, [1988-89 Transfer Binder] Fed.Sec.L.Rep. (CCH) ¶ 84,326 (Sept. 22, 1988).

BIA has a substantial interest in the matters before this Court because adoption of a short limitations period or a statute of repose for Rule 10b-5 actions would deprive defrauded bond purchasers of the only meaningful avenue of recovery for deliberate frauds directed against them. None of the express rights of action in the 1933 and 1934 Acts are applicable to tax-exempt municipal bond frauds, and because of the structure and nature of municipal bond financings, the short limitations period urged by Petitioner would deny a remedy to defrauded bond buyers.

SUMMARY OF ARGUMENT

In the last ten years, there have been at least 750 municipal bond defaults totalling over $9,200,000,000 in principal amount.[3] When industrial development or revenue bonds are issued to finance the construction or improvement of a project, a portion of the bond sale proceeds are held in capitalized interest and debt service reserve funds in order to pay interest on the bonds during construction and start-up of the project. Even if the bond issue is a sham, bondholders often have no reason to suspect fraud for several years because they will receive their scheduled interest payments from the reserve funds. Because the express rights of action in the 1933 and 1934 Acts are inapplicable to tax-exempt municipal bond frauds, and discovery of such frauds is often impossible as a practical matter within a three-year statute of repose, such a short limitations period would deny a remedy for securities fraud to purchasers of defaulted municipal bonds.

The BIA urges the Court to continue the traditional practice of borrowing state limitations periods. Unlike the cases in which this Court has looked to federal analogies to supply a limitations period, Congress has acquiesced in this practice in 10b-5 actions for over four decades, and decisions of this Court shaping the law of Rule

[3]Laing, *The New Junk? Risks Are Rising in the Vast Municipal Bond Market*, Barron's, Oct. 29, 1990, at 10, col. 2. Photocopies of all newspaper and magazine articles have been lodged with this brief.

10b-5 have relied to a significant extent on the practice. If the Court does choose to abandon the traditional practice of applying state law limitations periods, BIA urges the Court to adopt the five-year limitations period enacted by Congress in the Insider Trading and Securities Fraud Enforcement Act of 1988[4] or the three-years from discovery limitations period found in the Interstate Land Sales Full Disclosure Act, 15 U.S.C. § 1701 et seq. Both alternatives provide better analogies to 10b-5 actions than the periods suggested by the Petitioner.

ARGUMENT

I. MOST SECURITIES FRAUDS ARE NOT DISCOVERABLE WITHIN A THREE-YEAR STATUTE OF REPOSE

Like foxes piously guarding the chicken coop, the petitioning defendants ostensibly seek to add to the effectiveness of § 10(b) and Rule 10b-5 actions by urging the adoption of the limitations period created in *In re Data Access Sys. Sec. Litigation*, 843 F.2d 1537 (3d Cir.), *cert. denied*, 488 U.S. 849 (1988), which requires that 10b-5 actions be filed within one year from the date of discovery[5] of the fraud, but no more than three years after the "violation." (See Petitioner's Brief at 6). Under the guise of promoting the "effectiveness" of the Act, the defendants instead seek to emasculate 10b-5 actions by depriving defrauded investors of their right to sue. Simply put, defrauded investors in the unregulated municipal bond market cannot reasonably be expected to discover the sort of deliberate fraud prohibited by Rule 10b-5 within three years of the sale of the securities.

The municipal bond market is not an inconsequential aspect of the investment world. There are approximately $830 billion in face amount of municipal bonds currently outstanding,[6] more than three

[4]Pub. L. No. 100-704, § 5, 102 Stat. 4681 (adding Section 20A(a), 15 U.S.C. § 78t-1(a)).

[5]The Third Circuit did not directly address the issue in *Data Access*, but in *Gruber v. Price Waterhouse*, 911 F.2d 960, 964 n. 4 (3d Cir. 1990) that court held that its discovery rule is one year from actual, rather than inquiry, notice.

[6]Farrell, *Once Upon A Time, A Muni Was A Muni Was A Muni . . .*, Business Week, December 31, 1990, at 121, col. 1.

times the face amount of all corporate bonds in the market.[7] During the past decade, over $9 billion in municipal bonds have defaulted and the default rate is currently $1 billion per year.[8] Although the municipal bond market in years long past was dominated by institutional investors, in recent years increasing amounts of municipal bonds have been sold to individuals.[9] Many municipal bond purchasers are unsophisticated, elderly retirees,[10] some of whom may not fully appreciate the difference between general obligation bonds (which are backed by the full faith and credit of the municipal issuer)[11] and revenue bonds (the principal and interest of which are to be repaid from revenues of the financed project).[12]

[7]Laing, *The New Junk? Risks Are Rising in the Vast Municipal Bond Market*, Barron's, Oct. 29, 1990, at 10, col. 2.

[8]*Id.* See also Stevens, *Congress Urged to Ban Muni Issuers From Selling Conduit Bonds*, The Bond Buyer, May 8, 1990, at 1, col. 2; Boyle, *Defaults Leap 36.6% In The First Quarter, Investors Group Says; Two Issues to Blame*, The Bond Buyer, Ap. 5, 1990, at 1, col. 2; *Bond Defaults Rise in First Quarter*, The Commercial and Financial Chronicle, Ap. 4, 1990, page 15; Luxenberg, *Beware of Municipal Junk Bonds*, The New York Times, Dec. 11, 1988, at F6, col. 3.

[9]In addition, mutual funds, which are marketed primarily to individual investors, have increased their holdings of municipal bonds dramatically. Six years ago, 60 muni funds held only $13.2 billion in assets, but as of October, 1990, 190 muni funds now hold $68.7 billion of muni debt. Farrell, *Once Upon A Time, A Muni Was A Muni Was A Muni . . .*, Business Week, Dec. 31, 1990, at 121, col. 1. At the same time, however, credit ratings have been dropped on New York City, Philadelphia, and Massachusetts bonds, *Id.*, at 120, col. 3, and about half the states are taking in less revenue with which to repay their bonds than forecasted. *Id.* Philadelphia's credit rating has been lowered to CCC, one notch above "default." T. McCarroll, *City on the Brink*, Time, January 7, 1991, at 58.

[10]*In the Matter of Transactions in the Securities of the City of New York, Final Report*, [1979 Transfer Binder] Fed.Sec.L.Rep. (CCH) ¶ 81,936 (Feb. 5, 1979).

[11]Even general obligation bonds default and become the subject of SEC enforcement actions. Securities Exchange Act Release No. 26100, [1988-89 Transfer Binder] Fed.Sec.L.Rep. (CCH) ¶ 84,326, at 89,448 n. 1. Some municipal issuers' credit, even when it backs a bond, is not worth much, as was demonstrated by the New York City fiscal crisis and government bail-out in the 1970s. See *In the matter of Transactions in the Securities of the City of New York, Final Report*, [1979 Transfer Binder] Fed.Sec.L.Rep. (CCH) ¶ 81,936 (Feb. 5, 1979); *Friedlander v. City of New York*, 71 F.R.D. 546 (S.D.N.Y. 1976); *Spector v. City of New York*, 71 F.R.D. 550 (S.D.N.Y. 1976). Even today, cities such as Philadelphia are facing credit crunches and currently are "going through financial contortions to avoid defaulting on [their] GOs." Farrell, *Once Upon A Time, A Muni Was A Muni Was A Muni . . .*, Business Week, at 121, col. 1.

[12]Sing, *Simple Steps To Avoid Municipal Bond Scams*, The Los Angeles Times, Mar 18, 1989 § IV, at 3, col. 1.

Such so-called revenue bonds make up more than 60% of today's $830 billion bond market, and 70% of all new tax-exempt bond issues are revenue bonds.[13] Although revenue bonds nominally are issued by some governmental authority as a conduit, the moving force behind the issuance of revenue bonds is typically the private enterprise seeking the funds.[14]

Because the only source of funds to pay interest to bondholders is the revenue of a project not yet in service, a portion of the proceeds from the sale of the bonds is set aside to service the bond debt until the revenue stream is sufficient to do so. For example, if the bonds are used to finance the construction of a nursing home or retirement facility, it will be necessary to construct the project, market it and achieve a given occupancy level in order to generate the positive cash flow necessary to service the bond debt. The bond proceeds must provide sufficient funds to pay the interest on the bonds in addition to construction costs and other expenses during this construction and start-up period, which typically lasts several years. Accordingly, a portion of the proceeds from the sale of the bonds is usually allocated for "capitalized interest" and paid to the indenture trustee to be deposited into an interest- payment account. Additional funds, such as the "debt service reserve fund," are designed to provide funds to service the bond debt after the capitalized interest account is exhausted and to make up any shortfalls in the project's operating revenues in the event of a shortfall of revenues. See Guin & Donaldson, The Insider Trading and Securities Fraud Enforcement Act: Has Congress Supplied a Limitations Period Appropriate for Use in Private 106-5 Actions?, 47 Wash. &

[13]Farrell, *Once Upon A Time, A Muni Was A Muni Was A Muni . . .*, Business Week, Dec. 31, 1990, at 121, col. 1.

[14]See Hylton, *Junk Forecast: Wide Premiums*, The New York Times, Jan. 25, 1990, at D10, col. 3. Many states' laws allow developers to declare just about any parcel of land a special "taxing district, with their decision to float bonds rubber stamped by county commissioners. See Charlier, *Junk Munis; Many Tax-Free Bonds Are Going Into Default In Colorado Land Bust*, The Wall Street Journal, December 7, 1990, page 1, col. 6. The local commissioners have every incentive to cooperate with developers since the developers envision building new projects within the county or municipality with money raised from outsiders who will have no recourse against the municipality in the event of default. The lack of oversight coupled with high front-end fees is a ready-made breeding ground for fraud.

Lee. L. Rev. 541, 570 (Summer 1990) (hereinafter, "Guin & Donaldson").

Bond investors rarely have any inkling of even normal economic problems, much less fraud, until a coupon interest payment is missed.[15] Typically, interest is paid semi-annually. With the minimum eighteen to twenty-four month capitalized interest reserve fund, the first missed interest payment will not occur for at least twenty-four to thirty months after the initial closing of the bond issue and perhaps longer if the debt service reserve fund or some working capital reserve fund created with sources other than bond proceeds are utilized. See Guin & Donaldson, at 570-71. The database maintained by the BIA indicates that over the last ten years, the average time span between the issue date for municipal bonds which later defaulted and the date of default in the repayment of the bonds was 54.3 months (approximately 4.5 years). *Cf.* Staff Report on Transactions in the Marine Protein Corp. Ind. Dev. Revenue Bonds, [1979 Transfer Binder] Fed.Sec.L.Rep. (CCH) ¶ 82,049 (April 11, 1979) (bonds defaulted four years after issuance, SEC found deliberate fraud).[16] Accordingly, the earliest point at which bondholders reasonably can be expected to learn that anything at all is amiss with their investment would be near or after the expiration of the *Data Access* limitations period. *Id.*

The difficulty of discovering bond fraud is compounded by the fact that the municipal bond market is essentially unregulated. Municipal bonds are exempt from the registration requirements of the 1933 Act,[17] the periodic reporting requirements of the 1934 Act,[18] the Trust Inden-

[15]See Fritz, *X-Rated Bonds*, Forbes, Mar. 21, 1988, at 167, which reports that sometimes municipal bond trustees often do not report defaults at all. See also Ferris, *Trustee Data Should Be Put In Repository For Disclosure*, The Bond Buyer, April 4, 1988.

[16]In the *WPPSS* case, for example, because the proceeds of the bonds were to be used to finance the construction of nuclear power facilities, the construction period reserve funds lasted significantly beyond the three-year cut off of the *Data Access* rule. See, e.g., Staff Report of the Investigation in the Matter of Transactions in Washington Public Power Supply System Securities, [1988-89 Transfer Binder] Fed.Sec.L.Rep. (CCH) ¶ 84,327, at 89,461-462 (Sept. 22, 1988).

[17]§ 3(a)(2) of the 1933 Act, 15 U.S.C. § 77c(a)(2).

[18]§§ 3(a)(12), 12(a), 13(a), 14(a) and 16(a) of the 1934 Act, 15 U.S.C. §§ 78c(a)(12), 78l(a), 78m(a), 78n(a) and 78p(a).

ture Act Requirements,[19] and, generally, the registration requirements of blue sky laws in the state of issuance.[20] Therefore, there are no uniform requirements as to what information has to be provided to bondholders. In the typical revenue bond issue with a passive issuer, bondholders and would-be investors are dependent upon the indenture trustee, who has little budget for public dissemination of financial and other periodic reports, for information on the status of the project financed by the bonds. Individual trust indentures vary widely in any covenants they contain as to what information (if any) the project sponsor must furnish the indenture trustee, or the date as of which it must be furnished. Indenture trustees operating under a tax-exempt bond indenture generally are not privy to the information that would be required to be disclosed by 1934 Act reporting companies, and to the extent indenture trustees are in possession of any material information about the project, they often disclose such information only reluctantly, if at all.[21]

Even if the trustee does decide to notify the bondholder of the promoters' financial difficulties or of a default in the repayment of the interest and principal on the bonds, it will not necessarily put bondholders on notice of a possible fraud.[22] Projects financed by bond issues can fail for reasons having nothing to do with fraud and the potential defendants are likely to blame the default on unforeseen post-closing events. Since revenue bonds are secured by the project constructed with the bond proceeds, bondholders also do not know at the time of default whether they will suffer a loss on their investment, and if so, how much the loss will be. The project may remain open, close, be sold at foreclosure, be refinanced, or be foreclosed on. Guin & Donaldson, at 569-71.[23]

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[19]Trust Indenture Act of 1935, § 4(a)(4)(A), 15 U.S.C. § 77ddd(a)(4)(A).

[20]See, e.g., Uniform Securities Act § 402(a)(1), 1 CCH Blue Sky Law Reporter ¶ 5542.

[21]See J.E. Spiotto, *Defaulted Securities: The Prudent Indenture Trustee's Guide* (American Bankers Assoc. 1990).

[22]Another difficulty is caused by the fact that many bonds are held in "street name," and the beneficial owners of such bonds may receive any trustee notices very late if at all. Further, trust indentures rarely require trustees to mail regular reports or financial information to bondholders.

[23]One recently-published manual for indenture trustees even cautions trustees to advise the bondholders that it "may be in [their] best interests . . . to be patient and not to proceed immediately to litigation or other remedies." J.E. Spiotto, *Defaulted Securities: The Prudent Indenture Trustee's Guide*, at XII-14 (1990).

A three-year statute of repose will prevent 10b-5 actions from being a viable remedy for many defrauded investors or an effective deterrent to would-be malfeasors.[24] Because the express rights of action are inapplicable to municipal bond frauds, adoption of a short limitations period for Rule 10b-5 actions will leave defrauded bond purchasers with only inadequate state law remedies.[25] Such a result is inconsistent with the purpose of Rule 10b-5 because the federal securities statutes were enacted to rectify deficiencies in state law protection and to establish higher standards of conduct in the securities industry. *Herman & MacLean v. Huddleston*, 459 U.S. 375, 389 (1983); see *SEC v. Capital Gains Research Bureau, Inc.*, 375 U.S. 180, 186 (1963).[26]

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[24]The practical inability to discover fraud within three years is not peculiar to municipal bonds. Any financial fraud can be difficult to uncover, at least until the business folds. Similarly, garden variety "Ponzi schemes," in which the malfeasor induces the victim to invest with promises of high returns, which in fact, are paid only out of other investments, can be carried out as long as new investments can be obtained. In the classic Ponzi, the malfeasor pockets all of the invested funds not used to create the phoney "return." More often, the malfeasor makes the scheme more sophisticated (and more difficult to detect) by funneling a portion of the investments into actual business operations which create a phoney "return" by using investor funds to cover losses. This latter type of scheme can be virtually undetectable for an extended period of time because the investor, upon inquiry, can observe an actual, operating business. See, e.g., *Thousands Reportedly Hit by Ponzi Schemes - - Investors Bilked Out of More Than $750 Million*, L.A. Times, June 9, 1985, Part V, at 8; D. Akst, *How Barry Minkow Fooled the Auditors*, Forbes, October 2, 1989, at 126; Stern & Giltenan, *"Norma, Would I Do Anything to Hurt You?"*, Forbes, June 13, 1988, at 37; *The Whiz Kid Who Wasn't*, Time, January 25, 1988.

[25]*Cf. Woolf v. S.D. Cohn & Co.*, 521 F.2d 225, 227-28 (5th Cir. 1975), noting that the effectiveness of Rule 10b-5 is particularly important in the case of unregistered securities, such as municipal bonds and the limited partnership interests at issue here due to the lack of SEC oversight and publicly available information.

[26]Many defrauded investors, because of the small amount of their individual claims, rely on the class action device to seek redress. See *Deposit Guaranty Nat'l Bank v. Roper*, 445 U.S. 326, 338-39 (1980). However, a number of federal courts have held that state law rights of action brought as pendent claims to Rule 10b-5 actions are inappropriate for class action treatment. See, e.g., *Kirkpatrick v. J.C. Bradford & Co.*, 827 F.2d 718, 725 n. 6 (11th Cir. 1987). While BIA disagrees with those decisions, until this Court reverses their holdings, defrauded investors will have no practical means of redress if this Court adopts the short limitations period suggested by Petitioner. The limitations period will be too short to obtain redress under Rule 10b-5, and in at least some circuits, cheated investors will have no right to pursue a class action under common law theories.

II. STATE LIMITATIONS PERIODS, TEMPERED BY THE FEDERAL DOCTRINES OF EQUITABLE TOLLING AND EQUITABLE ESTOPPEL, SHOULD CONTINUE TO BE BORROWED FOR RULE 10b-5 ACTIONS

A. Data Access *Directly Conflicts with Supreme Court Pronouncements Regarding 10b-5 Limitations Periods*

1. Data Access *Conflicts With Supreme Court Decisions on 10b-5 Law Generally*

The *Data Access* approach is in direct conflict with this Court's decisions in the seminal Rule 10b-5 cases of *Ernst & Ernst v. Hochfelder*, 425 U.S. 185 (1976) and *Herman & MacLean v. Huddleston*, 459 U.S. 375 (1983). In *Hochfelder*, this Court stated:

> Since no statute of limitations is provided for civil actions under § 10(b), the law of limitations of the forum state is followed as in other cases of judicially implied remedies. See *Holmberg v. Armbrecht*, 327 U.S. 392, 395 (1946). Although it is not always certain which state statute of limitations should be followed, such statutes of limitations usually are longer than the [one-year/three-years] period provided under § 13 [of the Securities Act of 1933].

425 U.S. at 210 n. 29.

Not only did this Court in *Hochfelder* recognize the applicability of this traditional borrowing rule to 10b-5 actions, that conclusion was important to its ultimate ruling that scienter is an element of the cause of action. The Court held that it would be appropriate to impose a scienter requirement in Rule 10b-5 actions, among other reasons, because plaintiffs in 10b-5 actions are not hampered by the short three- year statute of repose placed on certain of the express securities rights of action.[27]

In *Huddleston*, this Court similarly stated,

[27]If this Court reverses itself and adopts some previously-existing federal limitations period for 10b-5 actions, it should revisit its imposition of a scienter requirement in Rule 10b-5 actions as well.

> [C]ourts [in Rule 10b-5 actions] look to the most analogous statute of limitations of the forum state, which is usually longer than the [one-year/three-years] period provided for Section 11 actions.

Id., at 384 n.18. The Court again relied to a significant extent on the fact that Rule 10b-5 limitations periods adopted from the forum states, when coupled with the federal equitable tolling doctrine, generally are longer than the periods for express civil liabilities under the 1933 Act in concluding that Rule 10b-5 actions and the express civil liability sections of the 1933 Act are not mutually exclusive. The Court reasoned that because the elements of a Rule 10b-5 claim impose a significantly greater burden on the plaintiff than the express civil liability sections, and because the scope of liability under 10b-5 is more expansive than the relatively limited express rights of action, and because the limitations period for Rule 10b-5 actions accordingly is longer than for such express provisions, plaintiffs should be permitted to join claims for violation of Rule 10b-5 with claims for violations of the 1933 Act.[28]

Albeit it in footnotes, this Court has twice stated not only that courts should look to the most analogous state limitations period in Rule 10b-5 cases, but that the limitations period for 10b-5 actions is longer than the one-year/three-years limitation period urged by the Petitioner.

2. Data Access *Conflicts With This Court's Rulings on Equitable Tolling*

The one-year/three-years limitation provision suggested by the Petitioner also conflicts with decisions of this Court applying federal doctrines of equitable tolling and equitable estoppel. These deeply rooted doctrines hold that it is against equity and good con-

[28]Using the same analysis, courts noting the distinctions between Sections 9 and 18 of the 1934 Act and Rule 10b-5 have permitted 10b-5 actions to proceed even though Sections 9 or 18 would have provided an express remedy. See, e.g., *Chemetron Corp. v. Business Funds, Inc.*, 718 F.2d 725, 727-28 (5th Cir. 1983) (overlap with § 9(a)(4)); *Ross v. A.H. Robins Co.*, 607 F.2d 545, 555 (2d Cir. 1979), *cert. denied*, 446 U.S. 946 (1980) (overlap with § 18(a)). See 5 Jacobs, *Litigation and Practice Under Rule 10b-5* § 11.02 n. 33 (2d ed. 1990 revision).

science to permit a person to profit by his own wrongdoing. Adoption of a statute of repose such as that created in *Data Access* would permit swindlers to profit by trickery and deliberate concealment of their wrongdoing.

In *Holmberg v. Armbrecht*, 327 U.S. 392 (1946), the Court held:

> [F]raudulent conduct on the part of the defendant may have prevented the plaintiff from being diligent and may make it unfair to bar appeal to equity because of mere lapse of time. Equity will not lend itself to such fraud and historically has relieved from it. . . . [W]here a plaintiff has been injured by fraud and "remains in ignorance of it and without any fault or want of diligence or care on his part, the bar of the statute does not begin to run until the fraud is discovered, . . . "
>
> *This equitable doctrine is read into every federal statute of limitation.*

327 U.S. at 396-97 (citations omitted; emphasis added).[29]

It is significant that the opinions of this Court relied upon by the Petitioner — *Agency Holding* and *DelCostello* — did not borrow federal statutes containing a statute of repose.[30] Further, Congress has acquiesced in this practice for many years. Over the last several decades federal courts have agreed that although the court should borrow the state-law limitations periods, the issue of when the period begins to run is governed by the federal law of equitable toll-

[29]This doctrine is not limited to suits in equity. *Bailey v. Glover*, 88 U.S. (21 Wall.) 342, 349 (1874).

[30]In *Agency Holding*, the Court applied the four year statute contained in the Clayton Act, 15 U.S.C. § 15b, to actions under RICO. That limitations provision does not contain a statute of repose; in fact, the lower courts have held that the four year limitations period applied to RICO actions starts to run only when the plaintiff should reasonably have discovered the fraudulent scheme. See, e.g., *Bankers Trust Co. v. Rhoades*, 859 F.2d 1096 (2d Cir. 1988); *Pocahontas Supreme Coal Co. v. Bethlehem Steel Corp.*, 828 F.2d 211 (4th Cir. 1987). The movants' position thus creates an additional anomaly in that under their view Congress intended to cut off 10b-5 actions after three years, whereas it is now generally held that supposedly stale 10b-5 claims may be revived under the guise of a RICO action.

ing.[31] BIA urges the Court not to approve any judicially crafted limitations period for 10b-5 actions that includes a statute of repose.[32]

B. *Resort to State Law Remains the Norm for Borrowing of Limitations Periods*

The Court has adhered to the time-honored practice of borrowing state limitations periods in all but the most unusual cases. Nothing about Rule 10b-5 actions justifies a departure from this procedure. This Court described the practice as "well settled" in *McCluny v. Silliman*, 28 U.S. (3 Pet.) 270, 276-77 (1830). See also *Campbell v. City of Haverhill*, 155 U.S. 610, 616 (1895). The Court in *Holmberg v. Armbrecht*, 327 U.S. 392, 395 (1946) again recognized the validity of the process, and also held that this absorption does not preclude a federal court from also applying the federal doctrine of equitable tolling.

[31]See, e.g., *Gaudin v. KDI Corp.*, 576 F.2d 708, 712 (6th Cir. 1978); *Durham v. Business Management Assoc.*, 847 F.2d 1505, 1508 (11th Cir. 1988); *Semegen v. Weidner*, 780 F.2d 727, 733 (9th Cir. 1985); *Suslick v. Rothschild*, 741 F.2d 1000, 1004 (7th Cir. 1984); *Summer v. Land & Leisure, Inc.*, 664 F.2d 965, 968 (5th Cir. 1981); *Ohio v. Peterson, Lowry, Rall, Barber & Ross*, 651 F.2d 687, 691-92 (10th Cir.), *cert. denied*, 454 U.S. 895 (1981); *IIT v. Cornfeld*, 619 F.2d 909, 929 (2d Cir. 1980); *Cook v. Avien, Inc.*, 573 F.2d 685, 694 (1st Cir. 1978); *Vanderboom v. Sexton*, 422 F.2d 1233, 1240 (8th Cir. 1970), *cert. denied*, 400 U.S. 852 (1970).

[32]A further issue that is presented if this Court adopts some form of a statute of repose for 10b-5 actions is whether the doctrine of equitable estoppel may be applicable. This Court has consistently held that a defendant may be estopped to plead the statute of limitations where his conduct has induced the plaintiff to refrain from filing suit and where the defendant's assurances have lulled the plaintiff into a false sense of security. E.g., *Schroeder v. Young*, 161 U.S. 334 (1896); *Glus v. Brooklyn Eastern District Terminal*, 359 U.S. 231, 232-33 (1959). This principle of equitable estoppel has on occasion been applied to the one-year/three-years limitation period in § 13 of the 1933 Act. See *Katz v. Amos Treat & Co.*, 411 F.2d 1046, 1055 (2d Cir. 1969); *Dyer v. Eastern Trust & Banking Co.*, 336 F.Supp. 890 (N.D. Me. 1971) (§ 12(1)); *Eaton v. Coal Par of West Virginia, Inc.*, [1983-84 Transfer Binder] Fed.Sec.L.Rep. (CCH) ¶ 99,675 (S.D. Fla. 1984) (§ 12(1)). BIA agrees with these courts which have applied the doctrine of equitable estoppel to § 13 limitations periods, and believes that if this Court adopts a statute of repose similar to § 13, assuming it applies the new limitations period retroactively, it should remand the case to the trial court to determine the applicability of the equitable estoppel doctrine. See Joint Appendix, at 40-41, 146-47, and 250-51 for Respondents' allegations of fraudulent concealment justifying equitable estoppel.

More recently, in *Auto Workers v. Hoosier Cardinal Corp.*, 383 U.S. 696 (1966), the Court held that a union's suit against an employer for breach of a collective bargaining agreement under § 301 of the Labor Management Relations Act, 29 U.S.C. § 185, which contains no statute of limitations, was properly governed by the Indiana six-year statute for actions on unwritten contracts. The Court rejected the argument that the action should be governed by the six-month limitations provision governing unfair labor practice proceedings, 29 U.S.C. § 160(b).

In the two cases principally relied on by the Petitioner, *DelCostello v. Teamsters*, 462 U.S. 151 (1983) and *Agency Holding Corp. v. Malley-Duff & Associates, Inc.*, 483 U.S. 143 (1987), the Court adopted a federal limitations period only as an exception to the general rule, and in both instances, it extended the limitations period rather than shortened it.

DelCostello involved a labor relations claim, but unlike *Hoosier*, it was a "hybrid" action involving breach of a collective bargaining agreement by the employer and breach of a duty of fair representation by a union. It was therefore consistent with traditional borrowing practices to look to federal law for a limitations period due to the unique situation presented by two separate forms of action being brought as a "hybrid" claim. If the Court had insisted upon borrowing a state law claim, it would have had to look to the different forms of action making up the hybrid claim, and the limitations periods for those two separate forms of action adopted from state law could vary significantly.[33]

The Court's decision to adopt a federal limitations period for RICO actions in *Agency Holding* was similarly appropriate due to the unique nature of civil RICO actions. Whereas the Court in *DelCostello* faced the task of finding one appropriate limitations period for a hybridized cause of action, in *Agency Holding*, it had to find a limitations period for a mongrel. The basis of a civil RICO violation is a pattern of commissions of various "predicate acts."

[33]Further, the Court found that the more analogous state law limitations provision would be a 30-day limitations period applicable to actions to set aside arbitration awards. The Court rejected such a short limitations period because it was too short to promote the federal policies at stake.

18 U.S.C § 1964(c). Each predicate act may consist of a violation of any number of federal or state law criminal violations. Absent one uniform federal limitations period, the trial court could be faced with the unenviable task of applying as many different state limitations periods as there were alleged predicate acts.

Because of those circumstances peculiar to RICO actions, the Court in *Agency Holding* held that the four-year statute of limitations under the Clayton Act, 15 U.S.C. § 15b, applied to all civil cases under RICO. The Court held that the Clayton Act provided the *closest* analogy to civil RICO not only because of the statutes' similarity in purpose and structure, including the similarity of the elements of the claims, compare 15 U.S.C. §15(a) with 18 U.S.C. §1964(c), but because the RICO cause of action was modeled directly upon the Clayton Act. 483 U.S. at 152. Moreover, the Court specifically observed that because a RICO action is premised on a pattern of widely varying predicate acts, each of which may be analogous to a state law claim having a different limitations period, "there is no comparable single state law analogue to RICO." *Id.*

The Petitioner is wrong in its contention that this Court took some bold step in *Agency Holding* and invited courts to discard the traditional practice of applying state law limitations periods. In *Reed v. United Transportation Union*, 488 U.S. 319 (1989), the Court's most recent pronouncement on the issue, this Court held that claims by a union member under § 101(a)(2) of the Labor Management Reporting and Disclosure Act, 29 U.S.C. § 411(a)(2), alleging that the union violated its members' free speech rights, are governed by the forum state's general or residual personal injury statute of limitation. Despite the same potential for a lack of uniformity engendered by adopting state limitations periods, the Court reasoned that because such claims were "readily analogized" to state personal injury actions, resort to federal law was unnecessary. The *Reed* Court reiterated that *DelCostello* recognized only "a closely circumscribed exception to the general rule that statutes of limitations are to be borrowed from state law." 488 U.S. at 324.

To abandon the traditional rule in this case would allow the exception to swallow up the rule. The first published opinion in which a federal court adopted a state limitations period for a 10b-5 action

was forty-one years ago in *Osborne v. Mallory*, 86 F.Supp. 869 (S.D.N.Y. 1949). Prior to *Data Access*, all twelve circuits which hear federal securities cases had upheld the practice. See Guin & Donaldson, at 547, 574. As discussed above, this Court recognized and relied upon the practice of borrowing state law limitations periods in developing the law of 10b-5. During the four decades since *Osborne*, Congress has made no effort to "correct" this area of the law, thereby indicating its acquiescence in the 10b-5 decisions of the lower courts over a period of several decades. As this Court noted in *Agency Holding*, "we can generally assume that Congress intends by its silence that we borrow state law." 483 U.S. at 147. *Cf. Basic, Inc. v. Levinson*, 485 U.S. 224, 230-31 (1988) (observing that "judicial interpretation and application, *legislative acquiescence*, and the passage of time have removed any doubt that a private cause of action exists for a violation of § 10(b) and Rule 10b-5") (emphasis added). This Court in *Huddleston* also recognized Congress' acquiescence in, and interpreted approval of, the substantial body of 10b-5 case law that had developed prior to *Data Access*:

> In light of this well-established judicial interpretation, Congress' decision to leave § 10(b) intact suggests that Congress ratified the cumulative nature of the § 10(b) action. See *Merrill Lynch, Pierce, Fenner & Smith v. Curran*, 456 U.S. 353, 381-82 (1982). . . .

459 U.S. at 385-86. The same can be said of the traditional practice of adopting state limitations periods: in light of this well-established judicial interpretation over the course of more than four decades, Congress' decision to leave the limitations period for 10b-5 actions intact suggests that Congress has ratified the practice.[34] As elsewhere stated by this Court,

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[34]This congressional acquiescence in the adoption of state limitations periods for 10b-5 actions is particularly persuasive in light of the fact that in 1975, Congress "comprehensively revised the securities laws" and enacted the "'most substantial and significant revision of this country's Federal securities laws since the passage of the Securities Exchange Act in 1934.'" *Huddleston*, 459 U.S. at 384-85 (citation omitted). Those revisions did not include a statute of limitations for 10b-5 actions despite prior pleas for reform.

> [S]tate statutes have repeatedly supplied the periods of limitations for federal causes of action when federal legislation has been silent on the question . . . . *Yet when Congress has disagreed with such an interpretation of its silence*, it has spoken to overturn it by enacting a uniform period of limitations. . . . Against this background, we cannot take the omission in the present statute as a license to judicially devise a uniform time limitation for §301 suits.

Auto Workers v. Hoosier Cardinal Corp., 383 U.S. 696, 704 (1966)(emphasis added). Neither should this court take judicial license to amend Section 10(b) and Rule 10b-5.

C. *Claims Under Rule 10b-5 Do Not Fall Within the DelCostello Exception for Utilizing Federal Limitations Periods*

1. *Rule 10b-5 Limitations Periods Should Be Determined on a Statute-by-Statute Basis*

The first step of the *DelCostello*-exception analysis is to determine "whether all claims arising out of the federal statute 'should be characterized in the same way, or whether they should be evaluated differently depending upon the varying factual circumstances and legal theories presented in each individual case.'" *Agency Holding*, 483 U.S. at 147. Rule 10b-5 claims should be analogized to state law for limitations purposes on a statute-by-statute basis rather than a claim-by-claim basis. See *Wilson v. Garcia*, 471 U.S. 261, 269-70 (1985) and *Owens v. Okure*, 488 U.S. 235 (1989) (holding that the general or residual personal injury statute of limitations of the forum state should always be adopted for civil rights actions under 42 U.S.C. § 1983).

It would be anomalous, for example, to adopt a two-year limitations period for actions by buyers by analogizing to state blue sky law, but to adopt a four-year limitation period for sellers by analogy to a common-law fraud limitations period. See *Friedlander v. Troutman, Sanders, Lockerman and Ashmore*, 788 F.2d 1500, 1504 (11th Cir. 1986) (Adopting the *Wilson* rationale in a 10b-5 action and adopting the forum state blue sky limitations period for all 10b-5 actions, whether asserted by buyers or sellers).

Adoption of 10b-5 limitations periods on a statute-by- statute basis comports with this Court's rulings in *Wilson, Owens*, and *Reed v. United Transp. Union*, 488 U.S. 319, 325-26 (1989). This Court need not throw the baby out with the wash to achieve uniformity. As in those cases, adoption of state limitations periods on a statute-by-statute basis will remove the collateral litigation regarding the appropriate limitations period for each case without taking the drastic step of adopting a federal limitations period, such as that suggested by Petitioner, which was developed to further purposes different from those of 10b-5.[35]

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[35]Contrary to the Petitioner's assertions, the Eleventh Circuit adopted that formulation after *DelCostello* and that court reaffirmed the rule last year by denying review of it *en banc*. See *Smith v. Duff & Phelps*, 891 F.2d 1567, 1570 (11th Cir.), *rehearing en banc denied*, 904 F.2d 712 (11th Cir. 1990). Nor has *Data Access* been as universally lauded as the Petitioner suggests. See, e.g., *Bath v. Bushkin, Gaims, Gaines & Jonas*, 913 F.2d 817 (10th Cir. 1990) (rejecting *Data Access*); *Nesbit v. McNeil*, 896 F.2d 380, 384 (9th Cir. 1990) (same). The Fifth Circuit in *Jensen v. Snellings*, 841 F.2d 600, 606 (5th Cir. 1988) rejected an argument premised on *Agency Holding* that the limitations period for 10b-5 actions should be based on the one-year/three-years rule of § 29 of the 1934 Act, and instead adopted the forum state's limitation period for blue sky claims. The Sixth Circuit has twice rejected the same analysis utilized by the Third Circuit in *Data Access* because of the need for a longer, versus a shorter, limitations period in 10b-5 actions and because of this Court's reliance in *Hochfelder* on the fact that limitations periods for 10b-5 actions generally are longer than those for the express rights of action in the 1933 and 1934 Acts. See *IDS Progressive Fund, Inc. v. First of Michigan*, 533 F.2d 340, 342 (6th Cir. 1976) and *Nickels v. Koehler Management Corp.*, 541 F.2d 611, 614-15 (6th Cir. 1976), *cert. denied*, 429 U.S. 1074 (1977). See also *Roney & Co. v. Goren*, 875 F.2d 1218 (6th Cir. 1989) (noting that the law for 10b-5 actions in the Sixth Circuit is to adopt the most closely analogous limitations period of the forum state, though recognizing the Third Circuit's contrary position). See also *In re Professional Financial Management, Ltd.*, 703 F.Supp. 1388, 1392-93 (D. Minn. 1989) ("The reasoning stated in *Agency Holding Corp. v. Malley-Duff* does not compel the same outcome for § 10(b) and Rule 10b-5 claims as for those under RICO."); *In re Atlantic Financial Mgt. Inc. Sec. Litigation*, 718 F.Supp. 1003, 1010 (D. Mass. 1988) ("The reason that the Court made an exception for civil RICO claims is the variety of substantive predicate offenses which can underlie such actions. This is not the case with section 10(b) and Rule 10b-5 actions, which are all based on violations of securities laws.") (citation omitted).

2. *The Suggested Federal Alternatives Do Not Provide A Closer Analogy Than State Law to Rule 10b-5 Actions*

Although 10b-5 actions satisfy the first branch of the *DelCostello* test in that 10b-5 claims generally should be treated in the same manner, the second and third tests are failed. The second branch of the *DelCostello* exception for resort to federal instead of state law requires that a "rule from elsewhere in federal law clearly provides a *closer* analogy than available state statutes." 462 U.S. at 172 (emphasis added). Petitioner asks the Court to adopt the "one-year/three-year limitations period in the 1933 and 1934 Acts" for all Rule 10b-5 actions. (Petitioner's Brief, at 10.) The Petitioner incorrectly assumes, as did the *Data Access, Short*,[36] and *Ceres*[37] courts, that the statutes of limitation applicable to the express causes of action in the 1933 and 1934 Acts are identical. Although those three circuits all purport to adopt a general one-year/three-years limitation period, each circuit's formulation of that one- year/three-years period differs markedly. See Guin & Donaldson, at 563-65; SEC Amicus Brief, at 26-29. More importantly, the striking differences between Rule 10b-5 and the express causes of action in the 1933 and 1934 Acts to which those limitations periods apply undercut the Petitioner's position.

The causes of action relied upon by Petitioner in the 1933 and 1934 Acts are no more analogous to Rule 10b-5 than blue sky law causes of action. Both the Petitioner and Respondent Comdisco, Inc. argued, for example, that blue sky laws can be distinguished from 10b-5 on the grounds that some blue sky laws protect only purchasers and not sellers and that some provide causes of action against only sellers and not aiders and abettors. (Petitioner's Brief, at 22; Respondent Comdisco's brief, at 23). The same can be said of §§ 11 and 12 of the 1933 Act, on which Petitioner relies. Indeed, the civil liability provision of the Uniform Securities Act, § 410, Unif. Sec. Act (1958), which has been adopted by most states,[38] is based on and is virtually identical to § 12 of the 1933 Act.

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[36]*Short v. Belleville Shoe Mfg. Co.*, 908 F.2d 1385 (7th Cir. 1990) (petition for cert. pending).

[37]*Ceres Partners v. GEL Assoc.*, 918 F.2d 349 (2d Cir. 1990).

[38]1 CCH Blue Sky L. Rptr. ¶ 5500.

Nor are the 1933 Act causes of action as similar to Rule 10b-5 as the Petitioner suggests. The express rights of action found in §§ 11 and 12 of the 1933 Act are either strict liability or negligence-based actions. See *Herman & MacLean v. Huddleston*, 459 U.S. 375, 381-84 (1985). Unlike 10b-5 claims, the 1933 Act claims require no proof of reliance, scienter, causation, or even damages. Even the burden of proving negligence, or the lack thereof, is shifted to the defendant. *Id.* Moreover, neither § 11 nor § 12 is applicable to claims by purchasers of tax-exempt municipal bonds.[39] The Seventh Circuit in *Short v. Belleville Shoe Mfg. Co.*, 908 F.2d 1385 (7th Cir. 1990), *petition for cert. filed.*, 59 U.S.L.W. 3278 (U.S. September 26, 1990)(No. 90-526) premised its analysis on purported analogies between Rule 10b-5 and § 12(2) claims. That court completely ignored the different proof requirements under the two sections that are critical to the statutes of limitation issue, as well as the inapplicability of § 12(2) to many securities and potential defendants in 10b-5 actions.[40]

The *Ceres* and *Data Access* courts purported to premise their analyses on a comparison of Rule 10b-5 with the rights of action found in the 1934, rather than the 1933, Act,[41] but those rights of action also differ significantly from 10b-5 actions. Section 9 of the 1934 Act is unlike the catch-all Rule 10b-5, which is aimed at curbing new and innovative manipulative devices and schemes not explicitly addressed in the 1933 and 1934 Acts. (See Petitioner's Brief, at 6.) Instead, § 9 is "expressly and unambiguously directed toward a narrow species of cases," (see Petitioner's Brief, at 43, distinguishing the five-year limitations period of ITSFEA), and ap-

[39]Sections 11 and 12(1) apply only to securities for which a registration statement was or should have been filed, and municipal bonds are exempt from such filing requirements. Section 12(2) expressly excludes tax-exempt bond issues from its purview.

[40]The Court noted these distinctions in the *Hochfelder* and *Huddleston* cases. See also *Blue Chip Stamps v. Manor Drug Stores*, 421 U.S. 723, 730 n. 4 (1975)(referring to the "contrast between the provisions of Rule 10b-5 and the numerous carefully drawn express civil remedies provided in the acts of both 1933 and 1934").

[41]The Third Circuit in *Data Access* purported to adopt a general one-year/three-year rule found in both the 1933 and 1934 Acts, but now has retreated from that position and contends that its new limitations period is based solely on provisions of the 1934 Act. *Gruber v. Price Waterhouse*, 911 F.2d 960, 964 n. 4 (1990).

plies only to securities registered on a national exchange (and therefore is inapplicable to the securities at issue in this case, or to municipal bonds), and in fact, applies primarily only to a series of six precisely defined forms of securities price manipulations on national exchanges. See § 9(a)(1) through (6). Section § 9 does not appear to impose a reliance requirement and the cause of action may for the most part be asserted only against brokers or dealers who deal directly with the plaintiff. Further, unlike 10b-5 actions, the § 9 cause of action focuses narrowly "upon the amount actually paid by an investor for stock that had been the subject of manipulative activity." *Piper v. Chris-Craft Indus. Inc.*, 430 U.S. 1, 46 (1977).[42]

The only securities to which § 9 is applicable are subject to the reporting requirements of the Exchange Act. See § 9(f). The companies whose securities are subject to § 9 must file annual and quarterly reports (Forms 10-K and 10-Q) with the SEC and must provide similar information directly to shareholders and to the market. Their officers, directors and major shareholders also must file reports with the SEC under § 16 whenever they trade in securities of the company, and the company is required to file with the SEC a report (Form 8-K) disclosing any particularly material events with respect to the company's business. Audited financial statements are required to be filed and delivered to shareholders in those reports.[43]

[42]As Professor Loss has noted, the right of action under § 9(e) "has been a dead letter so far as producing recoveries has been concerned." L. Loss, *Fundamentals of Securities Regulation* 920 (2d ed. 1988).

[43]Such companies also may be subject to the reporting requirements of any exchange on which their securities are traded. The following stock exchange rules are illustrative:

> A corporation whose securities are listed on the New York Stock Exchange, Inc. is expected to release quickly to the public any news or information which might reasonably be expected to materially affect the market for those securities.

New York Stock Exchange Company Manual, A-18 and § 202.05 (1983).

> A listed company is required to make immediate public disclosure of all material information concerning its affairs except in exceptional circumstances.

American Stock Exchange Guide, 101 and § 401 (1983).

Under NASD rules, the securities of an issuer may be refused quotation in the market if the issuer does not "promptly ... disclose to the public through the press

With all that information being disseminated to the market, discovery of facts constituting possible fraud can be more easy than typical securities which are not subject to such stringent reporting rules. Similarly, claims under § 18(a) of the 1934 Act apply only to false or misleading reports filed with the SEC (which, again, is inapplicable here, or to municipal bonds). Like the 1933 Act claims, § 18 does not require proof of scienter and the burden is shifted to the defendant to prove that he acted in good faith.

These distinctions also undercut the Petitioner's arguments based upon the legislative history of the 1934 Act. In anticipation of the argument that many frauds cannot be discovered within the short limitations period it urges this Court to adopt, the Petitioner argues that Congress considered and rejected a longer statute of limitations. Petitioner's brief at 37-42. Petitioner quotes a statement by a Senator Barkley that it would be "manifestly unfair . . . to limit any damaged party to 1 year or 2 years or 3 years in the bringing of a suit, because it may sometimes take 4 or 5 years to discover that a fraud has been committed . . . " Petitioner's brief at 40, note 58, quoting 78 Cong.Rec. 8201 (1934)(Statement of Senator Barkley of Kentucky). Petitioner then argues that the Senate rejected Senator Barkley's argument, but it does not point out the basis of the rejection. In response to Senator Barkley's concern, Senator Austin stated:

> I inquire of the Senator from Kentucky whether he does not recognize another exceptional circumstance in that the burden on proof is shifted around on the question of knowledge or willfulness in a misrepresentation. The committee have put the burden on the defendant, so that in this case the plaintiff does not have to spend any time going out and seeking his evidence. All he has to prove is the fact of misrepresentation.

78 Cong.Rec. 8201 (1934).[44] This colloquy indicates that the short

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any material information which may affect the value of its securities or influence investors' decisions." *National Association of Securities Dealers Manual*, Schedule D, Part 11, § (B)(3)(b).

[44]The SEC's brief, and Guin & Donaldson, discuss a number of other distinctions between 10b-5 actions and the express rights of action in the 1933 and 1934 Acts.

limitations periods applicable to some[45] of the express rights of action in the 1933 and 1934 Acts were adopted only because of the limitations placed on those causes of action.

3. *The Federal Policies At Stake and the Practicalities of Litigation Do Not Make Any Alternative Federal Limitations Periods More Appropriate for 10b-5 Actions:*

Rule 10b-5 claims also do not satisfy the third DelCostello requirement for departing from the norm — "when the federal policies at stake and the practicalities of litigation make [the rule from elsewhere in federal law] a significantly more appropriate vehicle for interstitial lawmaking." 462 U.S. at 172. The federal policy at stake in 10b-5 actions is "protection of the investing public and the national economy through the promotion of 'a high standard of business ethics . . . in every facet of the securities industry.' " *Bateman Eichler, Hill Richards, Inc. v. Berner*, 472 U.S. 299, 315 (1985), quoting *SEC v. Capital Gains Research Bureau, Inc.*, 375 U.S. 180, 186-87 (1963). See also, e.g., *Tcherepnin v. Knight*, 389 U.S. 332, 336 (1967) (central purpose to protect investors).

Petitioner has failed to identify any substantial federal interest furthered by a new limitations and repose period. The Third, Second and Seventh Circuits could do no better than to indicate that a short limitations period would help clear their dockets.[46] As to the "practicalities of litigation," the Second, Third and Seventh Circuits bemoan the "lack of uniformity" to which those decisions, ironically, have added. If uniformity is a paramount objective, then a federal limitations period must always be chosen whenever a federal cause of action lacks an express limitations period. The Petitioner and the circuit court decisions it cites accordingly ignore this

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[45]Of course, although the Petitioner purports to urge adoption of the general one-year/three-years schema of the 1933 and 1934 Acts, it ignores the five-year limitation period of § 20A discussed *infra*.

[46]Such overcrowding is not the result of class action securities fraud actions. Filings of securities fraud class actions have dropped by over 50% since the early 1970s. Whereas 305 securities fraud class actions were filed in federal courts in 1974, only 118 were filed in 1989. 12 *Class Action Reports*, at 316 (July-August 1989). BIA submits that the reduction in the filing of securities class actions is not the result of increased honesty in the market place.

Court's decisions in *Wilson v. Garcia*, 471 U.S. 261 (1985) and *Owens v. Okure*, 488 U.S. 235 (1989), which chose state limitations periods for § 1983 civil rights claims over federal alternatives, and *Reed v. United Transportation Union*, 109 S.Ct. 621 (1989), which chose a state limitations period over federal alternatives for union member claims under § 101(a)(2) of the Labor Management Reporting and Disclosure Act. This Court was aware in those cases that by approving the adoption of state limitations periods, there would be some lack of uniformity and some potential for forum shopping,[47] but those interests were outweighed by the objective of providing an effective remedy.

Because of the difficulties of discovering deliberate frauds in our complex securities markets, the practicalities of litigation require a longer, rather than a shorter, limitations period. See, e.g., *IDS Progressive Fund, Inc. v. First of Michigan*, 533 F.2d 340, 344 (6th Cir. 1976); *Berry Petroleum Co. v. Adams & Peck*, 518 F.2d 402, 409 (2d Cir. 1975); *United California Bank v. Salik*, 481 F.2d 1012, 1015 (9th Cir.), *cert. denied*, 414 U.S. 1004 (1973).

III. IF A FEDERAL LIMITATIONS PERIOD IS TO BE ADOPTED, THERE ARE BETTER ALTERNATIVES THAN THOSE SUGGESTED BY THE PETITIONER

If the court creates a new federal limitations period, the court should not attempt to create some new period out of an agglomeration of the various one-year/three-year rules for the older express remedies of the 1933 and 1934 Acts. There are at least two alternative federal limitations periods that would conform to stated congressional policy and better serve the federal interests at stake.

A. *The Five-Year Period for 10b-5 Types of Fraud Conducted by Insiders, Insider Trading and Securities Fraud Enforcement Act of 1988, 15 U.S.C. § 78t-1(a) ("ITSFEA")*

The statute of limitations in § 20A of ITSFEA provides a more appropriate limitations period than that suggested by the Petitioner.

[47]There is no showing in the record that "forum shopping" is a significant problem in 10b-5 cases, and Congress has expressly provided plaintiffs with a choice of venues under § 27 of the 1934 Act.

Section 20A of the 1934 Act was enacted by Congress as part of ITSFEA to expand the scope of 10b-5 actions. The five-year limitations in ITSFEA is the only statement of congressional intent on the issue of what limitations period Congress deems appropriate for at least some forms of 10b-5 cases.

When Congress enacted the one-year/three-years statutes of limitations in 1934 for certain of the express rights of action, it could not have "intended" for that same limitations period to apply to 10b-5 actions since the implied right of action under Section 10(b) did exist at that time. The legislative history of the 1934 Act does not indicate that Congress even considered the possibility of implied actions under § 10(b). See *In re Data Access*, 843 F.2d at 1547.

Congress enacted ITSFEA, on the other hand, against a backdrop of four decades of judicial decisions construing Rule 10b-5. In fact, ITSFEA was enacted with the specific intent of expanding the scope of Rule 10b-5 by overturning cases denying recovery under Rule 10b-5 for insider trading based upon the misappropriation theory.[48] H.R. Rep. No. 910, 100th Cong., 2d Sess., at 26, *reprinted in* 1988 United States Code Cong. and Admin. News, at 6063. ITSFEA's legislative history acknowledges that private 10b-5 claims "have traditionally served as an important supplement to the Commission's enforcement of federal securities laws," H.R. Report No. 910, 100th Cong., 2d Sess. at 26, reprinted in 1988 U.S. Code Cong. & Admin. News 6063, that ITSFEA was intended to broaden the scope of 10b-5, and that Congress intended to give the courts leeway to develop implied private rights of action under 10b-5 "*in an expansive fashion in the future.*" *Id.*, at 27 (emphasis added).

The history of § 20A of ITSFEA also indicates that the express liability provisions of ITSFEA were designed to work hand-in-hand with implied private causes of action under 10b-5. ITSFEA contemplates that various private causes of action for injuries caused by

[48]Those cases generally relied upon this Court's analysis in *Chiarella v. United States*, 445 U.S. 222 (1980).

insider trading should be implied outside the "contemporaneous trader" situation.[49]

In anticipation that the SEC would urge adoption of the five-year ITSFEA rule for other 10b-5 actions as well, the Petitioner has attempted to distinguish 10b-5 claims generally from insider trading claims. Although the Petitioner is correct that ITSFEA applies only in insider trading cases, the same arguments can be made with respect to each of the express causes of action on which the Petitioner relies. If § 20A is an inappropriate choice for adoption because of the distinctions between 10b-5 claims alleging insider trading and 10b-5 cases generally, then *a fortiori*, the alternatives suggested by Petitioner are inappropriate, because the distinctions between 10b-5 and the express rights of action in the 1933 and 1934 Acts are even greater. Although insider trading is but one variety of a 10b-5 violation, it is nonetheless a 10b-5 violation.[50]

Moreover, to assume that Congress intended a longer statute of limitations to apply to § 20A than to garden variety 10b-5 claims defies common sense. Congress recognized that the two causes of action overlap. The House Report accompanying the act pointed out that the *Anheuser-Busch* case discussed above would give rise to

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[49]As an example of an implied cause of action pursuant to Rule 10b-5 in the insider trading concept, the Report points to *Anheuser-Busch Companies, Inc. v. Thayer*, CA3-85-0794-R (N.D. Texas 1986), in which a tipper disclosed the plaintiff's intent to acquire another corporation, thereby pushing up the price of the stock by insider trading and allegedly increasing the tender offer price by $80 million. The Report recognized that Anheuser-Busch, the plaintiff in the case, was not a "contemporaneous trader," for whom an express cause of action would have existed under the 1934 Act under then-existing case law. It concluded, however, that an implied 10b-5 cause of action *should* exist on Anheuser-Busch's behalf but wished to clarify in ITSFEA what sorts of insider trading would constitute a violation of Rule 10b-5. H.R. Report at 28.

[50]Congress enacted ITSFEA in order to extend the breadth of Rule 10b-5 actions to those alleging insider trading based upon the misappropriation theory. Further, unlike § 9 or 18 claims of the 1934 Act, or § 11 or 12 claims of the 1933 Act, the elements of proof for a § 20A action are identical to the elements of any other 10b-5 action. (See SEC Amicus Brief, at 16-17.) Unlike the express rights of action, scienter, causation, and damages all are elements of the cause of action, and the difficulty of discovering insider trading, if anything, is less than the difficulty of discovering financial fraud or other deliberate securities frauds due to the availability to stockholders of information regarding all insiders' purchases and sales of their corporation's securities.

both implied 10b-5 actions and express causes of action under § 20A. Moreover, in considering ITSFEA, Congress took into account the fact that some economists and academics favor legalizing insider trading on the theory that it promotes efficient markets. Report at 7. In addition to such relatively benign activities as insider trading, § 10(b) covers such obviously nefarious practices as Ponzi schemes in which innocent people are cheated out of their life's savings. In light of the fact that some of the same activities are encompassed by both sections and in light of the fact that some 10b-5 claims involve activities far worse that insider trading, it is illogical to assume that Congress intended for insider trading to have a longer statute of limitations than an action that is based on intentional fraud.[51]

B. *The Three-Year Period in a 10b-5 Clone, The Interstate Land Sales Full Disclosure Act, 15 U.S.C. § 1701, et seq. is also more apposite than the alternatives suggested by the Petitioner.*

A second alternative is found in the Interstate Land Sales Full Disclosure Act, 15 U.S.C. § 1701 et seq. Section 1703(a)(2)(A),(B) and (C) of that Act as amended in 1979 duplicates the language of Rule 10b-5, except that it applies to the fraudulent interstate sale of resort and other properties rather than to securities. Section 1709(a) of the Act creates a cause of action based upon that 10b-5 clone, and section 1711(a)(2) of the Act establishes a limitations rule of "three years after discovery of the violation or after discovery should have been made by the exercise of reasonable diligence."

This Court has noted that *when originally passed*, the Interstate Land Sales Full Disclosure Act was modeled on the 1933 Act and had disclosure as its central purpose. *Flint Ridge Dev. Co. v. Scenic Rivers Ass'n of Oklahoma*, 426 U.S. 776, 778-79 (1976). But by

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[51]The Seventh Circuit has indicated that the five year ITSFEA rule can be equitably tolled, and BIA agrees with that limited portion of the Seventh Circuit's opinion in *Short v. Belleville Shoe Mfg. Co.*, 908 F.2d 1385, 1391-92 (7th Cir. 1990), *petition for cert. filed.*, 59 U.S.L.W. 3278 (U.S. September 26, 1990)(No. 90-526).

1979, Congress recognized that the statute was not fulfilling its objective, which was to combat extensive fraud in the land sales industry simulating fraud in the sale of securities. Congress noted that as in the securities business, con men offering to sell or lease land were often using sophisticated sales teams who would promise that the land (which was under water or suitable only for grazing) "was a good investment" and "easily resalable." H.R. Report No. 96-154, 96th Cong., 1st Sess. 30, reprinted in 3 U.S. Code Cong. & Admin. News 2346. Because Congress found that the original formulation of the act, which included a three-year statute of repose, was largely ineffectual, it amended the Act in 1979 "to conform more closely to the language of the securities laws," particularly Rule 10b-5, and significantly, Congress removed the three-year absolute limitation and increased the limitations period to three years from discovery. *Id.*, at 34-35, reprinted in 1979 U.S. Code Cong. & Admin. News 2350. Because the 10b-5 cause of action in the Interstate Land Sales Full Disclosure Act is identical to, and has the same elements and burdens of proof as, and the same goals as, Rule 10b-5, that cause of action provides as close an analogy to Rule 10b-5 actions as is imaginable.

CONCLUSION

This Court should adhere to its statement in *DelCostello* that "resort to state law remains the norm for borrowing of limitations periods," 462 U.S. at 171, and rule that federal courts must adopt the limitations period from the forum state's laws for securities fraud, and that such borrowed time period should start to run only after discovery of the violation or after discovery should have been made by the exercise of reasonable diligence. If a federal limitations period is adopted, the Court should adopt a limitations period that is subject to tolling in order to promote enforcement of the 1934 Act. BIA suggests that the Court adopt the five year limitations period of § 20A of the 1934 Act, coupled with equitable tolling, or the three-years from discovery limitations period of the Interstate Land Sales Full Disclosure Act.

Respectfully submitted,

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